Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

May 31, 2012

RE: PCAOB Rulemaking Docket Matter No. 038, *Proposed Auditing Standard — Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards*

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") *Proposed Auditing Standard — Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* (the "proposed standard," "proposed amendments," or "proposals"). Overall, we support the Board's proposals and believe they will heighten the auditor's focus on the potential for material misstatement, particularly material misstatement due to fraud, arising from relationships and transactions with related parties, significant unusual transactions, and financial relationships and transactions with executive officers. We believe our suggestions below will further improve the proposals and we encourage the Board to consider them in finalizing the proposals for issuance.

In the remainder of our letter, we have organized our suggestions about the proposals into the following topical areas:

- Proposed amendments to Auditing Standard No. 12
- Evaluating whether significant unusual transactions are indicative of fraud
- Use of the release text to interpret requirements
- Proposed effective date

Proposed amendments to Auditing Standard No. 12 (Question 19 in the release text)

Definition of senior management

The proposed amendments to PCAOB Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement* (AS 12) would, among other matters, enhance an existing requirement in paragraph 11 to consider obtaining an understanding of compensation arrangements with senior management. Specifically, under the proposed amendments the auditor would be required to perform certain procedures to obtain an understanding of the company's financial relationships and transactions with its *executive officers*, a subset of senior management that is defined in Appendix A, for purposes of identifying and assessing risks of material misstatement. Page A4-42 of the release states that the proposed amendments would not change the existing requirement in paragraph 11 which applies to senior management, a larger population than executive officers. Defining executive officers as a subset of senior management raises questions about who comprises the remaining population of senior management. We believe that, having defined "executive officers," the Board should also define the term "senior management" to enable consistency in executing the requirement to obtain an understanding of compensation arrangements, including incentive compensation arrangements, changes or adjustments to those arrangements, and special bonuses with respect to the population of senior management other than executive officers.

Clarifying the intent of the proposed amendments

The proposed amendments to AS 12 would require the auditor to make inquiries of the chair of the compensation committee, or its equivalent, and compensation consultants engaged by either the compensation committee or the company regarding the structure of the company's compensation for executive officers as part of the auditor's requirement to understand the company's financial relationships with its executive officers to identify the risks of material misstatement. Some compensation consultants are concerned that this might result in a company's compensation decisions being second guessed by the auditor, or that the auditor could consider certain compensation plan designs to be inappropriate. We believe that when the Board adopts a final standard, the Board should address this misunderstanding and clarify in the release text that the intent of the requirement is to focus auditors on identifying and assessing the risk of material financial statement misstatement due to financial arrangements with executive officers, not on forming a view of the appropriateness of the compensation programs.

Evaluating whether significant unusual transactions are indicative of fraud (Question 18 in the release text)

A proposed amendment to paragraph 67 of the Board's interim standard AU 316, *Consideration of Fraud in a Financial Statement Audit* (AU 316), would identify factors that the auditor should evaluate with respect to whether the business purpose (or the lack thereof) indicates that a significant unusual transaction may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets. We believe that the factor "the company's accounting for the transaction enables the company to achieve certain financial targets" should be deleted because it suggests that management's consideration of financial targets is, by itself, an indicator of fraud that the auditor should evaluate, even if the accounting is appropriate. We believe this could lead to unnecessarily evaluating transactions for fraud that clearly have not been entered into to engage in fraudulent financial reporting or misappropriation of assets. Furthermore, this factor is unnecessarily redundant because other factors in the proposed amendments address questionable accounting practices that we believe are the appropriate situations for the auditor to evaluate with respect to whether the company has engaged in fraudulent financial reporting or misappropriation of assets, including, for example, the factor that "management is placing more emphasis on the need for a particular accounting treatment than on the underlying economic substance of the transactions (e.g., accounting-motivated structured transaction)."

Use of the release text to interpret requirements

Consistent with our comments on various other PCAOB proposed standards, we believe that some of the guidance and examples that have been provided in the release text would drive more consistent execution if instead contained in the standard itself. Examples of requirements that we believe would be enhanced by moving guidance and examples from the release text into the standard are identified below.

Procedures to perform with respect to related party transactions and significant unusual transactions

Paragraph 15 of the proposed standard would require the auditor to perform certain procedures with respect to each related party transaction, or type of related party transaction, that is either required to be disclosed or determined to be a significant risk, including in subparagraph (d) to "perform other procedures as appropriate, depending on the nature of the related party transaction and the related risks of material misstatement, to meet the objective of this standard." Page A4-20-21 of the release text identifies the following examples of procedures that might be appropriate for the auditor to perform with respect to fulfilling the requirement of paragraph 15(d):

- Inquiring directly of the related party regarding the business purpose of the transaction;
- Inspecting information in the possession of the related party or other parties to the transaction, if available;
- Reading public information regarding the related party and the transaction, if any;
- Reading the financial statements or other relevant financial information obtained from the related party, if available, to understand how the related party accounted for the transaction;
- Confirming the terms of the transaction with other parties with knowledge of the transaction (e.g., banks, guarantors, agents, or attorneys), if any;
- Confirming whether there are any side agreements or other arrangements (either written or oral) with the related party;
- Evaluating the transferability and value of collateral provided by the related party, if any; and
- Performing procedures at the related party, if possible.

We believe the example procedures identified above are helpful to auditors and should be incorporated into the proposed standard as examples to supplement the requirement in paragraph 15(d).

Similarly, proposed new paragraph .66A to AU 316, *Consideration of Fraud in a Financial Statement Audit*, would require the auditor to perform certain procedures to obtain an understanding of the business purpose (or the lack thereof) of each significant unusual transaction. Such procedures are nearly identical to those discussed above in relation to paragraph 15 of the proposed standard, including in subparagraph .66A(d) a requirement for "performing other procedures, as appropriate, depending on the nature of the transaction and the risks of material misstatement, to obtain an understanding of the business purpose (or the lack thereof) of the significant unusual transaction." Page A4-37 of the release text identifies examples of procedures similar to those shown above that might be appropriate for the auditor to perform depending on the nature of the significant unusual transaction and the risks of material misstatement of the financial statements. We also believe these example procedures should be incorporated into the proposed amendments to AU 316 to supplement the requirement in paragraph .66A(d).

Assertions that transactions with related parties were conducted on terms equivalent to those prevailing in arm's-length transactions

Paragraph 19 of the proposed standard would require the auditor to determine whether the evidence obtained supports or contradicts management's assertion in the financial statements that transactions with related parties were conducted on terms equivalent to those prevailing in an arm's length transaction. If the auditor is unable to obtain sufficient appropriate audit evidence to substantiate management's assertion, and if management does not agree to modify the disclosure, the auditor should express a qualified or adverse opinion.

Footnote 35 on page A4-27 of the release text states that "a decision by management to remove, at the auditor's request, such an assertion from the financial statements due to management's inability to provide the auditor with sufficient appropriate audit evidence might impact the auditor's assessment of internal control over financial reporting." We believe this is important guidance that should be included as an additional Note in paragraph 19 of the proposed standard.

Inquiries of the human resource director

Paragraph 7 of the proposed standard requires the auditor to inquire of others within the company about the matters identified in paragraph 6 concerning related parties and relationships and transactions with related parties. Examples of others to whom inquiries might be directed include, in paragraph 7(e), the human resource director or person in equivalent position.

Page A4-43 of the release text states that this inquiry of the human resource director "also could provide an opportunity to the auditor to obtain an understanding of the company's financial relationship and transactions with its executive officers and how that relationship could create conditions that could result in risks of material misstatement, including fraud risks." We believe that inquiries of the human resource director or equivalent should be included among the Board's other proposed amendments to AS 12 that require the auditor to obtain an understanding of the company's financial relationships and transactions with its executive officers.

Proposed effective date (Questions 24 and 25 in the release text)

The Board anticipates that the proposed standard and proposed amendments would be effective, subject to approval by the SEC, for audits of financial statements for fiscal years beginning on or after December 15, 2012. We believe this anticipated effective date is reasonable if the SEC approves the Board's final standard no later than December 31, 2012 which should allow sufficient time for firms to implement required training in early 2013.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Michael J. Gallagher (646-471-6331), Brian R. Richson (973-236-5615) or Thomas Gaidimas (973-236-5036) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP